STATE OF MICHIGAN

MICHIGAN SUPREME COURT

J & J FARMER LEASING, INC., FARMER BROTHERS TRUCKING CO., INC. CALVIN ORANGE RICKARD, JR., and JAMES W. RILEY, as Personal Representative of the ESTATE OF SHARYN ANN RILEY, Deceased,

Plaintiffs-Appellees,

v

CITIZENS INSURANCE COMPANY OF AMERICA,

Defendant-Appellant.
_____/

S. Ct. No. 125818
Court of Appeals No. 239069
L.C. No. 96-3742 NO

125818

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CITIZENS' SUPPLEMENTAL BRIEF IN SUPPORT OF APPLICATION FOR LEAVE TO APPEAL

PROOF OF SERVICE

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INTRODUCTION

Citizens' Application for Leave to Appeal to this Court argues that, because the Court of Appeals' February 12, 2004, decision is erroneous, conflicts with a decision from this Court (and decisions from other courts), and raises issues of major significance to the State's jurisprudence, this Court should peremptorily reverse, or, at a minimum, review it pursuant to MCR 7.302(B)(3) and (5). Citizens will not reiterate those arguments here, except in the process of noting that Plaintiffs' response to Citizens' Application utterly fails to refute them. In the Argument section below, Citizens argues that Plaintiffs' Response is without merit, focusing, where appropriate, on the two questions that the Court's December 28, 2004, Order directed the parties to address at oral argument.

ARGUMENT

THIS COURT SHOULD REVIEW OR PEREMPTORILY REVERSE THE COURT OF APPEALS' PUBLISHED OPINION AFFIRMING THE DENIAL OF SUMMARY DISPOSITION OF A CLAIM ALLEGING BAD-FAITH FAILURE TO SETTLE BY CITIZENS, WHERE CITIZENS' INSURED IS INSULATED FROM PECUNIARY LOSS BECAUSE OF A RELEASE EXECUTED BY THE UNDERLYING PLAINTIFF, GIVEN THIS COURT'S HOLDING IN *FRANKENMUTH V KEELEY*, 433 MICH 525, 447 NW2D 691 (1989), *REV'D ON REH'G*, 436 MICH 372 (1990), THAT A BAD-FAITH FAILURE TO SETTLE CLAIM IS BASED IN CONTRACT AND, THUS, A PLAINTIFF'S RECOVERY IS LIMITED TO PECUNIARY LOSS SUFFERED BY OR ACTUALLY COLLECTABLE FROM THE INSURED

I. Plaintiffs' Response fails to refute that the Court of Appeals decision is erroneous and conflicts with *Keeley*, as demonstrated in Argument sections A and B of Citizens' Application

Plaintiffs' Response brief squarely addresses few, if any, of the arguments made in Citizens' Application. Whereas Plaintiffs' Response concludes that the Court of Appeals decision is consistent with *Keeley*, it fails to explain how this is so, specifically how Citizens'

argument to the contrary is incorrect. For example, Plaintiffs do not appear to disagree that the Court of Appeals opinion, in contravention of *Keeley*, departs from the principle of confining the damages for breach of contract by an insurer to the economic loss suffered by the promisee. See Citizens' Application, p 20.[1] Plaintiffs do not disagree that the Court of Appeals incorrectly surmised that Citizens is using what this Court intended to be a shield as a sword. See Citizens' Application, pp 21-23. Plaintiffs do not disagree that the Court of Appeals opinion, in contravention of *Keeley*, focuses on a perceived "windfall" to the insurer. See Citizens' Application, pp 25-26. Plaintiffs do not disagree that the objective of a bad faith failure to settle claim is to put the insured in the same economic position that the insured would have been in had there been no breach. See Citizens' Application, p 27. Plaintiffs make no attempt to address Citizens' argument that the flawed nature of the Court of Appeals' analysis is revealed in the Court's attempted application of the *Keeley* holding on page 10 of its opinion. See Citizens' Application, p 30. And Plaintiffs do not address the Court of Appeals' acknowledgement that Citizens' position represents a correct interpretation of how *Keeley* might be applied to the circumstances presented in this case. See Citizens' Application, p 20.

The arguments that Plaintiffs' Response does present are either irrelevant or incorrect, or both, and, in some cases, are arguments that were rejected by the Court of Appeals—and not appealed to this Court. Plaintiffs' argument that the Court of Appeals opinion is consistent with Keeley focuses mainly on the irrelevant fact that, under *Keeley*, "it is not necessary for the

[1] Nor do plaintiffs disagree that in Michigan a bad faith failure to settle claim is treated as a contract action that gives rise only to contract damages, not tort damages. See Citizens' Application, pp 17-18 (citing *Keeley I*, 433 Mich at 555-556). Indeed, they acknowledge that, under *Keeley,* "a bad faith cause of the [sic]action sounds in contract not in tort." (Plaintiffs' Response, p 21).

insured to make payment on the Judgment in order to establish damages." (Plaintiffs' Response, p 11). Citizens has not argued otherwise. It is, however, necessary for the insured to be exposed to potential pecuniary loss, since, if there can be no pecuniary loss, there is no grounds for a breach of contract action such as a bad faith failure to settle claim. That was the very point of Justice Levin's dissent, which was adopted as the Court's opinion. It is what distinguished Justice Levin's opinion from Justice Archer's opinion, which the Court rejected.

The errors in Plaintiffs' analysis begin in their counter-statement of question involved, at page vi.[2] Plaintiffs contend therein that the joint agreement between the Estate and the Farmer entities ("Agreement") did not release the Farmer entities from the excess judgment. Much of Plaintiffs' argument is based on this contention (See Plaintiffs' Response, pp 11-12, 15-20), which was also advanced in the Court of Appeals and rejected (Ct App Op pp 7-8).

The pertinent portion of the Agreement is paragraph 10((b), which provides that the Estate agrees to "forever forebear any action to collect any monies to satisfy the unpaid portion of the Judgment that the [Estate] has against the [Farmer entities]." By virtue of this language in the Agreement, the Farmer entities have been completely relieved of their legal liability to satisfy the unsatisfied portion of the judgment. As the Court of Appeals correctly recognized, this language "indisputably releases the Farmer parties from any obligation to pay the underlying judgment . . ." (Ct App Op, p 7).

Were there any ambiguity in this language of the Agreement (there is not), it is undisputed that it was the intent of the parties to the Agreement that the Farmer Parties were to be forever released from liability for the unsatisfied judgment. The principals to the Agreement,

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[2] Even before that, Plaintiffs incorrectly contend that Citizens' application was untimely under MCR 7.302(C)(2)(b) because it was filed 42 days after the Court of Appeals decision. (See plaintiffs' response, p v). The rule to which Plaintiffs refer was amended in 2003 to allow an application to be filed 42 days after the Court of Appeals decision.

Johnny Farmer, President of J&J Farmer, and James Riley, Personal Representative of the Estate, both testified that this was the intent, as did the Farmer Brothers' attorney, Robert Pollice. See Citizens' Application, p 29 n 15.[3]

Plaintiffs argue that a covenant never to execute is not the same thing as a "release," and that the Agreement did not extinguish the judgment (Plaintiffs' Response, pp 11-12, 15-20). But they do not explain why this makes any difference, assuming arguendo that they are correct. Whether the "forever forebear" language constitutes a covenant not to execute or a release is immaterial, as is the inquiry whether the judgment was technically extinguished. The issue is whether Citizens' insureds, the Farmers entities, have suffered or potentially will suffer pecuniary harm as a result of Citizens' alleged failure to settle. Plaintiffs do not argue that the mere existence of a judgment that can never be collected constitutes pecuniary harm, either in the abstract or as applied to the case at hand. The Court of Appeals correctly recognized that

[3] Plaintiffs argue, at some length, that parol evidence such as the deposition testimony of the principals who drafted the Agreement is inadmissible because the Agreement contains an integration clause. (See Plaintiffs' Response, pp 18-20). Citizens is not, as Plaintiffs suggest, attempting to "change" or "re-write" the Agreement with parol evidence. Quite the opposite, the deposition testimony of the principals to the Agreement is cited because it *confirms* the intent clearly expressed in the unambiguous words "forever forebear." Irrespective of that testimony, however, Plaintiffs beg the question "why was the word 'forever' added?" by arguing that the Agreement is "virtually identical" to the agreement that was used in *Keeley*. (Plaintiffs' Response, pp 5, 16). In citing the deposition testimony of the principals to the Agreement, Citizens is merely pointing out that the insertion of the word "forever" was intentional, not accidental, for the specific purpose of removing any possible doubt as to whether the agreement not to attempt to collect the unsatisfied judgment from the Farmer entities was to be perpetual. But Citizens certainly agrees with Plaintiffs that the Agreement speaks for itself. Consequently, Plaintiffs' reliance upon rules concerning the admissibility of parol evidence, particularly *UAW-GM Human Resource Center v KSL Recreation Corp*, 228 Mich App 486; 579 NW2d 411 (1998), only helps Citizens.

Plaintiffs' focus on the difference between a covenant not to execute and a release misses the point:

> Plaintiffs respond by arguing that the agreement contains a covenant not to sue, rather than a release. However, plaintiffs fail to explain why, in the context of this case, that distinction would make a difference. Regardless of whether the agreement contains a release or a covenant not to sue, the net effect is the same, i.e., the Farmer parties are no longer obligated to pay the underlying judgment. [fn: See *Insustrial Steel Stamping, Inc v Erie State Bank*, 167 Mich App 687, 693; 423 NW2d 317 (1988).] Relief from the obligation to pay is the key component to triggering the holding of *Keeley* and ultimately determining whether plaintiffs in this case can prove damages.

(Ct App Op, p 8).

Plaintiffs also argue that the Agreement does not constitute a release because of the possibility that it could become void (Plaintiffs' Response, pp 11, 15-16). This argument, too, was made by Plaintiffs unsuccessfully in the Court of Appeals. Initially, Citizens notes that Plaintiffs make no suggestion that the Agreement is expected to be declared void, or that circumstances under which the Agreement could be declared void are likely to arise—much less a suggestion supported by evidence. Plaintiffs' argument that a court cannot or should not give effect to an agreement where there is a theoretical possibility that the agreement could be declared void, if accepted, would essentially mean that no agreement could be given its intended effect. Virtually any agreement can be declared void under some imaginary circumstances.

Secondly, Plaintiffs' statement that there are "many situations which allow the Estate to deem the agreement null and void and execute on the excss Judgment" (Plaintiffs' Response, p 6 n 2) is not true. There is only one such situation, and it pertains to the cooperation of the Farmer entities—activity which is entirely within the Farmer entities' control. Pursuant to the Agreement there are four things that the Farmer entities must do in this regard: (1) execute

pleadings; (2) attend meetings with counsel; (3) comply with discovery; and, (4) attend evidentiary hearings or trial, if needed by counsel. (See paragraph 10(f) of the Agreement). Even if the Farmer entities do not comply with one of these four cooperation obligations, the Agreement, per its terms, still cannot be deemed null and void by the Riley Estate. Instead, the Agreement requires the Riley Estate to notify the offending party in writing of the breach to allow that party 15 days to cure the breach. (Agreement, paragraph 10(f)). If the offending party does not cure the breach during that time period, the Agreement provides:

> [T]hen the plaintiff may declare this agreement null and void as to the offending party, only, but not as to any other Defendant. In that event, and that event only, is the plaintiff permitted to take action to collect the unpaid portion of the Judgment from the offending party.

Id.

Setting aside the fact that Plaintiffs have not even argued—much less supported an argument with evidence—that there is a reasonable possibility the Farmer entities will fail to cooperate, and will also refuse to cure after being notified of such failure, Citizens submits that the Court is entitled to assume the insureds' cooperation with the Estate in this litigation would be given for two separate reasons. First, as the Court of Appeals correctly noted, such non-cooperation by the insureds would constitute action against their own interests, since it would have the effect of nullifying a clause that insulates them from attempts to collect the over-limits judgment. As this Court has recognized, "It is to be assumed . . . that each party [to a contract] is alert to protect his own interests and to insist on his rights . . ." *Detroit Greyhound Employees Federal Credit Union v Aetna Life Ins Co,* 381 Mich. 683, 692 (1969) (citing 17 Am Jur 2d, Contracts, § 274, p 685). Applying this principle, it is to be assumed that the Farmer entities are

alert to protect their own interests, and, therefore, will not take steps that would void the agreement that insulates them from exposure to the unsatisfied judgment.

The second reason the Court is entitled to give the Agreement its intended effect of insulating the Farmer entities from exposure to the judgment is that a party will not be allowed to take advantage of the party's own misconduct. See, e.g., *People v Washington*, 461 Mich 294; 602 NW2d 824 (1999); *Albert v Patterson*, 172 Mich 635; 138 NW 220 (1912). As set forth in Citizens' Application, the insureds are the only parties to whom a duty is owed in connection with a bad faith failure to settle claim; the Estate's rights are entirely derivative of Citizens' insureds. And yet the insureds are in a position to control, unilaterally, whether a bad faith claim can be brought in their behalf, as the argument goes, by failing to cooperate with the Estate and causing the agreement to be nullified. If for some reason the Farmer entities were to withhold cooperation in order to create a cause of action in their behalf, this would present a classic example of a party attempting to take advantage of its own misconduct, and would be prohibited as violating public policy.

Plaintiffs also argue that it was the intent of the parties to the Agreement "not to release Citizens but instead to require Citizens to pay for the excess judgment." (Plaintiffs' Response, p 12. See also Response, pp 17-18, 20). Assuming Plaintiffs are correct that it was the intent of the parties to the Agreement that Citizens should have to pay the unsatisfied judgment, that intent will not be given effect if to do so would be in violation of Michigan law, which is the case here. It was also the intent of the parties to the Agreement that Plaintiffs have successful claims of intentional infliction of emotional distress and negligence against Citizens. See Agreement, ¶ 6. But obviously that intent is subject to Michigan law regarding the elements for such claims. The same principle applies to Plaintiffs' desired bad faith failure to settle claim. Because, under

Keeley, there can be no bad faith failure to settle claim where the insured has not suffered and will not suffer pecuniary loss, there is no such claim here irrespective of the intent of the parties to the Agreement.

Plaintiffs' final argument regarding Michigan law is that Citizens' position is inconsistent with *Sederholm v Michigan Mut Ins*, 142 Mich App 372; 370 NW2d 357 (1985) (Plaintiffs' Response, pp 21-23). Neither the trial court nor the Court of Appeals agreed with Plaintiffs' argument based on *Sederholm,* which reflects a misunderstanding of the facts involved in that case, and, more importantly, fails to recognize that *Sederholm* was decided prior to this Court's decision in *Keeley*. Contrary to plaintiffs' suggestion, the fact that the *Sederholm* court considered a bad faith breach claim to give rise to damages in tort (not in contract), far from being irrelevant, is a key distinguishing factor. In response to the defendant's argument that it was "impossible for plaintiffs to allege any damage to [the insured] because of [the insurer's] refusal to settle", the *Sederholm* panel recognized that "between the date of the default judgment and the date of the second assignment, the insured was not insulated from liability after judgment was entered against her." *Id.*, at 399. Before *Keeley*, i.e., as of the time a bad faith breach claim was considered to give rise to damages in tort, it was possible to allege damages by virtue of the mere existence of an uncollected judgment against the bad faith breach plaintiff. But such an allegation can no longer be made in light of *Keeley*, which clarified, for the first time in Michigan, that damages for a bad faith breach claim *are limited to actual pecuniary harm suffered by an insured.* The mere pendency of an uncollected judgment for six days might give

rise to damages in tort, but it could not give rise to the type of pecuniary loss that it is now necessary for a bad faith plaintiff to demonstrate.[4]

II. Plaintiffs' Response fails to refute that the Court of Appeals' opinion conflicts with decisions from jurisdictions that have addressed this of similar issues, as demonstrated in Argument section C. of Citizens' Application

Plaintiffs do not address any of the out-of-state cases cited in Citizens' Application, except for the blanket assertion that "[t]he out of state cases relied upon by the Defendant were cases where there was collusion between the parties and there never was any excess liability faced by the insured." (Plaintiff's Response, p 25). Plaintiffs do not explain what they mean by "collusion", or what it means to "face[]" excess liability. There was certainly no more "collusion" between the underlying plaintiff and the insured in *Clement v Prudential Property & Cas Ins Co*, 790 F2d 1545 (11th Cir 1986); *Johnson v Acceptance Ins Co*, 292 F Supp 2d 857 (ND W Virg, 2003); *In re Tutu Water Wells Contamination Litigation*, 78 F Supp 2d 423 (DVI 1999); or *Willcox v American Home Assur Co*, 900 F Supp 850 (SD Tex 1995) than there was in the instant case. Nor did the insureds in those cases avoid facing the excess liability any more than did the insureds in the instant case. More importantly, the holdings in those cases, as discussed in Citizens' Application, were not based on any factors that might distinguish those decisions from the instant case. Insofar as any of the out-of-state cases cited in Citizens' Application are distinguishable on their facts, they are nonetheless persuasive for their on-point reasoning.

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[4] Plaintiffs also argue meekly that if Citizens' position is correct, then the Agreement is void for lack of consideration (Plaintiffs' Response, pp 20, 27). The Court of Appeals correctly rejected this argument as well, noting that the Agreement "contains several mutual agreements that support a finding that consideration was given." (Ct App Op, p 8). One particularly significant item of consideration, for example, is that the Farmer entities promised to waive their right to appeal the judgment and to instruct Citizens not to appeal as to the portion in excess of policy limits (paragraph 10(h)).

As for the out-of-state cases cited by Plaintiffs, not a single one involves the type of far-reaching agreement to "forever forebear" any action to collect on the judgment that is present in the instant case. Nor is there any indication from any of Plaintiffs' cases that the respective jurisdictions (California, Illinois, Nebraska, and Arizona) have adopted the hybrid judgment/prepayment rule for damages in bad faith breach cases that this Court adopted in *Keeley*. In any event, none of the cases cited by plaintiffs presents a reasoned basis why a bad faith claim should be allowed notwithstanding the absence of damages suffered by the insured. The courts in *Clement, supra*, *Johnson, supra, Willcox, supra*, and *In re Tutu Water Wells, supra*, persuasively reasoned that a bad faith breach claim cannot be asserted to allow recovery in excess of policy limits where the underlying plaintiff has agreed not to execute on the judgment. Defendant respectfully submits that a similar holding is required in the instant case in the wake of *Keeley*.

III. Plaintiff does not disagree that this case involves legal principles of major significance to the State's jurisprudence, as set forth in argument section D of Citizens' Application

Apart from its inconsistency with *Keeley*, Citizens argues that the Court of Appeals decision involves legal principles of major significance to Michigan jurisprudence, both in the area of contract litigation generally, and in bad faith failure to settle cases in particular, and, thus, should be reversed or reviewed by this Court pursuant to MCR 7.302(B)(3). See Citizens' Application, pp 36-38. In their Response, Plaintiffs do not disagree.

At the same time, Plaintiffs argue that Citizens provides no mechanism for recovery in this context; that Citizens' position, if accepted, would make it impossible for a bad faith failure to settle claim to be brought (Plaintiffs' Response, p 15). Plaintiffs are wrong on both counts.

Citizens does offer a practical mechanism to recover damages in this type of case: Instead of agreeing to forever forbear from collecting the judgment, the claimant can simply agree to refrain from executing on the judgment temporarily, which leaves the insured exposed to the judgment and, therefore, susceptible to pecuniary loss. (Citizens' Application, p 29). This mechanism allows for a bad faith failure to settle claim to proceed, and, unlike the Court of Appeals decision, is consistent with *Keeley's* requirement that the judgment must be "actually collectable" from the insured for the insured (or the claimant in the event of an assignment) to be able to argue pecuniary loss, and, therefore, proceed with a bad faith claim. *Keeley I,* 433 Mich at 565.

The second question the Court has asked the parties to address at oral argument is "Under what circumstances can an assignment of a bad faith claim allow the assignee's suit against the insurer to proceed?" Assuming the Court accepts the propriety of assigments in this context generally, *see, e.g., Rutter v King,* 57 Mich App 152, 162; 226 NW2d 79 (1974), and *Lisiewski v Countrywide Ins Co,* 75 Mich App 631; 255 NW2d 714 (1977), Citizens believes the answer to the question is: an assignee's suit against the insurer can proceed in any circumstance where the over-limits judgment remains actually collectable from the insured, i.e., where the potential for pecuniary loss on the part of the insured remains. For example, the underlying plaintiff could, in exchange for an assignment of the bad faith claim from the insured, agree to forbear from executing on the Judgment unless and until the bad faith claim is fully resolved.

As other courts addressing this issue have persuasively concluded:

> To recover more than the policy limits from the insurer, the judgment creditor must assert the insured's injury. If the judgment cannot be enforced against the insured, no such injury exists. **The insured may assign to his judgment creditor any claim he has against his insurer for payment of the excess award, but such**

assigned claim is actionable only as long as the insured remains liable for the excess damages. (emphasis added)

Willcox, supra, at 857; *Johnson, supra*, at 867 (citation omitted). This reasoning is wholly consistent with *Keeley.*

* * *

Citizens maintains, as argued in its Application, that the Court of Appeals' decision (1) is erroneous under Michigan law and cannot be reconciled with *Keeley*, whether the focus is on the letter of *Keeley* or the intent; (2) conflicts with the better reasoned, if not the only, cases from other jurisdictions that have decided this or similar issues within a similar legal setting; and (3) improperly alters Michigan law in a way that would have major significance to Michigan jurisprudence. Plaintiffs' Response refutes none of these points. Accordingly, this Court should peremptorily reverse, or, at a minimum, review the Court of Appeals decision.

RELIEF

For the reasons set forth above and in Citizens' Application, Defendant-Appellant Citizens first and foremost asks that this Court peremptorily reverse the Court of Appeals' opinion, and remand the matter to the trial court for entry of summary disposition in favor of Citizens. Failing that, Citizens asks that the Court grant leave to appeal the complained-of opinion. Citizens further requests any and all other relief to which it is entitled in equity and law.

Respectfully submitted,

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Dated: January 25, 2005

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